hypothetical network, how will RLECs, which lack the huge and varied customer bases of the large LECs, justify the cost of network advances, knowing that constant advances in technology, reflected in forward looking proxy costs, will likely erode the "costs" they may recover?

3. The Commission Should Specifically Commit Itself to Using the Statutory Universal Service Aims and Standards in Evaluating any Proposed RLEC Proxy.

Since the Recommendation intends a proxy model to quantify costs, not just to apportion actual costs among smaller geographical areas, it must be validated with the rigor suitable to that more demanding function. However, a model used to identify RLEC costs must also be flexible enough to take into account the numerous variables and impacts on service and investment that are peculiar to rural areas if it is to provide the "sufficient" support contemplated by section 254 for real-world particular cases. If adequate adjustments and individualized inputs do not "customize" the results adequately to reflect RLECs' actual investment and recovery needs, there will at least need to be a streamlined waiver process to preclude adverse impacts for rural customers, the rural economy and rural universal service providers from proxy inadequacies.

It will be very difficult to design a forward looking proxy model that can adequately take into account the continual upgrading necessary to keep up with the pace of developing technology and evolving universal standards. The proxy model seems particularly ill-suited to reflecting the cost and efficiency differences in constructing a new network, installing a wide range of network capabilities at one time or gradually evolving the infrastructure. In short, TDS and Century urge the Commission to (a) articulate the purpose, goals and standards for the proxy model it is seeking, (b) relate these to the statutory goals and purposes, (c) identify the differences that a model for RLECs must accommodate (d) quantify the effect of a specific proxy proposal on specific real-world rural areas and (e) develop effective ways to identify problems for particular LECs and respond with appropriate adjustments and waivers. In view of the short time before the May decision deadline, the Commission should act now to ensure that its efforts will be directed towards satisfying the 1996 Act. For example, the model must be held to a standard of identifying "sufficient" real-world costs if it is to identify "sufficient" high cost compensation.

4. The Commission Should Give Parties an Opportunity to Submit Comments and Price Outs on a Detailed, Firm Proposal Before Adopting Any Plan.

From the outset, TDS and Century have urged the Joint Board and the Commission to provide the chance to analyze and price out a firm, comprehensive proposed plan. The need remains crucial, especially since the Joint Board has recommended adopting whatever proxy comes out of the coming period of study and refinement. Companies without unlimited resources need to focus on a concrete proposal to assess its impact on their operations, their network advancement plans, their customers and their communities. TDS and Century are currently pursuing economic analysis and plan to offer the fruits of their consultation for the record when the work has been completed. However, for the critically important business decisions that telecommunications need to be making now about the nation's future infrastructure, it is essential to move beyond theory and abstractions to the point where economists and companies alike can test, validate and evaluate the real world impact of a sufficiently crystalized plan to arrive at some reliable conclusions.

B. The Recommendation's Effort to Slash High Cost Compensation by Terminating Eligibility for Many Rural Residential and Business Connections Rests on Fatally Flawed Premises.

On top of the selection of a proxy model which is likely to underestimate RLEC's actual costs per line by estimating hypothetical costs for an imaginary network and omitting RLEC variances, the Recommendation also evaluates the impact of its decisions on the basis of incorrect factual presumptions. It first supposes that RLECs' revenue flows will remain unchanged by the cost of their newly imposed contribution obligations. The Joint Board then conjectures that it can reduce total high cost compensation both indirectly and directly by withdrawing support for connections it deems less essential. However, assuming that costs per line are equal on first and additional lines is incorrect.

1. The Recommendation Overlooks the Impact of RLECs' New Contribution Responsibilities on High Cost Recovery.

The proxy cost and compensation calculations neglect to take into account a major change for RLECs in the universal service framework that will unfairly shift high cost burdens back to RLEC end users. In the past, RLECs have drawn high cost compensation from the federal mechanisms, but have not been asked to contribute beyond bearing carrier of last resort and other common carrier responsibilities. Section 254(d) of the statute now requires all providers of interstate service to contribute to the funding of the new mechanisms. However, the recommendation has not recognized the impact of the new contributions that RLECs must now pay into federal fund accounts for the high cost and low income mechanisms, as well as for the new school, library and rural health care provider discount mechanisms. These are real costs of operating even a hypothetical forward-looking network. It distorts conclusions about how proxy proposals will affect RLECs' high cost compensation not to take into account that contributions are new costs of providing service in RLEC areas. The Joint Board's assumption that freezing historic high cost compensation based on embedded costs during a transition period will prevent immediate distortions in RLEC recovery is inaccurate because the outflow of universal service contributions has the same effect as a reduction in the RLECs' "frozen" high cost support. The same error occurs in the Recommendation's assumptions that it can count on continuation of nationwide average historic revenues in looking at what costs RLECs can be fairly expected to recover from charges for services before the high cost compensation program becomes available. In effect, the Recommendation proposes to raise the already high costs to rural LECs of providing rural universal service decreasing the available high cost compensation, without even trying to measure the effect of that change -- to assume that transitional and subsequent RLEC high cost recovery will not be reduced below the required "sufficient" level to keep rates "affordable."

2. The Joint Board Has Needlessly Complicated the Proposed High Cost Proxy and Benchmark Plan to Eliminate Greatly Exaggerated Support Flows to Additional Connections.

The Joint Board seeks to cut back the existing level of high cost compensation by reducing the connections eligible for high cost mechanisms. Specifically, the Joint Board (¶¶89, 91) recommends reducing high cost compensation by restricting "per line" universal service compensation to the first line into a primary residence and a single line business connection. Its claim is that comparable rural and urban "access" to services satisfies section 254(b)(3) of the statute. It believes that affordable single line business and initial residence lines are all that is needed to provide service for "health, safety and employment reasons" (¶91). The Joint Board also recommends (¶ 92) a lower level of support per line for single line businesses than for a first connection to a primary residence. The Joint Board (e.g. ¶ 92) justifies its restrictive approach -- which it believes will withdraw high cost compensation from many lines that today qualify for per-line high cost compensation and reduce high cost compensation for others -- in large part because the law does not specify "what, if any, uses of a second connection are consistent with the goals of universal service" (¶ 89).

However, the Joint Board's notion that per line support costs will be reduced in proportion to the reduction in second or additional lines is an illusion. What the Recommendation has missed is that the principal cost for loops is incurred to put the first line in place. The incremental cost of providing a second connection, for example, when a $2,000 cost is incurred to deliver service to a remote customer, is not $1,000 or half the cost of the installation. Although high cost support has in the past been calculated as a single cost per line, even though the cost is largely in the first line, this did not cause economic harm when all lines were equally eligible and the line count simply spread the total high cost on a uniform basis. However, assuming that the second and additional lines actually incur a pro rata share of the costs and that the inflated cost imagined thereby for additional lines can be "saved" by denying them high cost support will create perverse incentives: It will encourage ILECs to overprice additional lines to prevent the loss of support that should properly be directed almost entirely to the first line. This pricing strategy would eliminate revenues now obtained for additional lines, discourage customers from having computer, fax or other connections at very little real cost and needlessly reduce an RLEC's inherently limited economies of scale and scope. The effect could be to deny rural customers the "affordable" access to advanced services and capabilities that is a basic purpose of universal service under section 254(b)(2). And reducing costs by only the relatively tiny incremental cost for the lines will leave in place the high cost and the support burden that the first line continues to cause. Consequently, the Recommendation has fashioned a cumbersome regulatory burden to solve a non-problem — speculative excess high cost support for connections the Joint Board apparently considers a luxury.

An economically realistic measure of unit costs in a high cost area would be the cost per customer. That more direct measurement of the cost of the first connection will do a far better job of quantifying and compensating high costs as they are actually incurred.

3. The Law Does Not Contemplate Comparability Only for Some Categories of Rural Rates and Services or Customers.

Even if the major cost savings were not illusory, the statute offers no authority or justification for limiting high cost compensation to a selected segment of rural end users or high cost connections. The Joint Board's contention (¶90-41) that customers can pay for second residential connections, all connections to other residences and all multi-line business connections is simply not relevant to the statutory framework for rural high cost recovery. The Recommendation, in fact, expressly adopts the opposite holding when it excludes income considerations from its revenue benchmark. "[W]e conclude," says the Recommendation (¶ 314),

> that the impact of household income should be addressed through programs directed at helping low-income households obtain and retain telephone service, rather than as a part of

our high cost mechanism.

That is what Congress intended. Indeed, §254(j) explicitly disclaims any intent for the Act to change "the collection, distribution or administration" of low-income support. In contrast, the statute does not limit its rural and urban parity principle to comparable "access," as the Recommendation would have it. The law speaks of access to services, and provides for rural services

> that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates that are charged for similar services in urban areas. 47 U.S.C. §254 (b)(3).

The record certainly does not indicate that rates for second residential lines, non-primary residences or multi-line businesses are subject to higher rates in urban areas. Given their low incremental cost, this would not be expected.

There is no hint in the law that Congress was contemplating increases in any residential or business rates. Proposals to endorse rate "rebalancing" in the law were not incorporated into the legislation. Furthermore, treating business customers differently, whether by exclusion of multi-line high cost support or providing less high cost support for even single line business connections -- is at odds with what Congress did with its interexchange averaging provision, 47 U.S.C. §254(g). When AT&T tried to limit averaging to "residential" service during the conference, the limitation was removed from the conference draft in which it had appeared.[19] Hence, excluding whole categories of high cost lines, residences and businesses violates the tenet of "reasonable comparability"[20] in rates and the services.

4. The Recommendation Has Not Explored the Effect of Terminating Support for Currently-Eligible Services.

The Recommendation seems to assume in proposing its revenues benchmark (¶311 et seq.) that rural customers and businesses will continue to pay for second residence connections and telephone connections in additional residences despite a possible boost in rural rates for those connections to make up for lost support (whether to raise connections for non-primary residences to full cost or to deter second line subscription) and prevent loss of support. There is no record support for assuming that those revenues will not be lost.

The Joint Board did not try to quantify the support, in current terms, at risk for being withdrawn. A rough estimate of the lines in TDS Telecom and Century LECs that will lose eligibility suggests that the impact could affect some 15-20% of the group's current high cost

[19]Compare staff draft dated December 22, 1995 (marked F: \ SAC \ TAGS \ TA 95.002, p. 45, with Section 254(g) and Proposed Technical Corrections (Addressed to 12/22/95 draft.)

[20]The Recommendation (¶89) brushes aside the practical administrative burdens and costs of determining, let alone policing, which lines or connections qualify for the high cost mechanism. LECs do not keep records of whether a residence is a first connection. Indeed, they are not likely to know whether a customer already subscribes to another LEC for its first connection. And the categories are not self-explanatory. For example, for a subscriber with existing wireless and wireline connections, which is the "initial" line? How will a LEC in a rural area that has attracted some vacationers ascertain whether a residence is a primary residence? Is a business with a small, single-line branch in a high cost line and multiple lines in its headquarters in the nearest city a single or multiline business?

lines. Few businesses are able to get by with only a single connection in the current information-laden business environment. Even farms and small rural businesses would find it a great competitive disadvantage if they had to pay significantly higher rates or do without either a fax machine connection or a data line. The fact is that there are few single-lines businesses today. Since there is no provision in the Joint Board's plan for increasing the high cost compensation for eligible lines if the newly ineligible lines are disconnected, the serving RLEC will experience a definite shortfall in cost recovery. And, it is not clear that state regulators will allow it to recover the shortfall in higher local rates to the remaining lines, especially since the Joint Board leaves it to the states to set "affordable" rates (¶31). Accordingly, there is no chance that the implementation of the Act planned by the Joint Board will "minimize the probability that residential rates would increase while the new support mechanisms are being implemented," as the Recommendation (¶309) claims the Joint Board intends. A rural subscriber household or farm with more than one line will not perceive its residential and business charges to have been successfully kept in line when a second residential or business line must recover the full weight of the area's high costs.

5. Limiting Eligibility Will Adversely Effect Rural Areas Contrary to the Statute's National Universal Service Commitments.

Beyond that, the decision to discriminate among high cost lines will jeopardize the rural economic development and infrastructure advances Congress intends by this legislation. Communications-intensive businesses that have flourished in some rural markets will confront disproportionately high costs for local connections that may well deter them from remaining or locating in rural areas. Investment in network advances will also be deterred because an RLEC will no longer have the same "critical mass" of lines priced at "reasonably comparable" levels from which it can expect to recover new investment in technological innovations and advanced services. Thus, the high cost support will not be "sufficient" to achieve the infrastructure investment and service advancement purposes of the new law. The Commission should abandon the Joint Board's plan to rewrite the law to exclude high cost compensation to those it deems insufficiently needy or otherwise undeserving of the nationwide comparability embraced by Congress. The goal of making high cost support "predictable," "explicit," "specific" and "sufficient" cannot rationally be addressed by immediate reductions in high cost programs that have allowed the rural networks to evolve.

C. A National Benchmark Must Not Mask the Relevant Differences in Rural Markets.

The Joint Board proposes (¶ 309) to establish high cost compensation for eligible rural connections as the difference between (a) each of two nationwide average revenue benchmarks (for first lines to primary residences and single line business connections) and (b) the proxy-model-generated "cost" for such lines. The Joint Board made a conscientious effort (¶¶ 299-317) to design a benchmark that would require customers in rural and urban markets to shoulder cost recovery burdens for their service before federal high cost compensation would become available. It was no doubt seeking to ensure "comparable" and "just, reasonable and affordable" rates in high cost rural markets. Despite the Joint Board's reasonable intention, the proposed benchmark will require modifications to take into account what rural customers pay for a similar package of services to what urban customers receive for their payments that generate ILEC revenues at the benchmark level.

The revenues per line measurement repeats the error of considering the cost and prices of second and additional lines as equivalent to the cost of the first line. Again, the appropriate comparison would be the proxy costs per customer and the revenues per customer. The benchmark also is of questionable validity because it attaches an "expectation" of continuing revenues from services that will be subject to competition and may dwindle or dry up. Moreover, even if the revenues per customer are eroded, the costs per customer will remain. Without further refinement, the revenue benchmark cannot hope to represent the fair nationwide customer payment presumed in the Recommendation.

The Recommendation also properly sets out (¶309) to find a nationwide benchmark that will be "easy to administer" and will "minimize the probability that residential rates would increase while the new support mechanisms are being implemented." Unfortunately, the benchmark, as proposed, cannot successfully fulfill either these Joint Board goals or the statutory goals the Joint Board realized were its ultimate duty — identifying (¶ 301) "the minimum subsidy required to achieve the statutory goal of affordable and reasonably comparable rates throughout the nation."

1. The Benchmark Rests on a Fundamentally Flawed Comparison.

In fact, the problem that revenue levels and services will certainly change also relates to a flaw that infects the whole concept of the proposed revenue benchmark, including its use in rural markets. The flaw is that the revenue benchmark looks at past revenues set to recover the actual embedded — "historical" — costs of a real network. These backward looking revenues are assumed to "offset" the forward-looking future costs of a hypothetical optimally efficient competitor. And, as noted in section II, above, the proxy and benchmark do not even take into account the future obligation to contribute to the universal service fund, which would have to be deducted from historic RLEC revenues.

A revenue benchmark to use with the proxy model must assume that only prospective -- i.e. forward-looking -- revenues will be available to offset the identified costs. Changes in a competitive market that will erode revenues are ignored in the historical revenue benchmark. Nor does the backward looking benchmark allow for variance as competition divides the market. The expectation that historical revenues represent available future revenues assumes that the ILEC will retain all the customers in its market.

As the forward-looking proxy model has not been designed, price outs and forecasts are not possible. However, with the intended new definition of eligible lines and new cost measurement paradigm, the prospective "offsetting" revenues plainly cannot be presumed to be the same as historical revenues. Moreover, the different customer profiles and demand patterns in rural and urban areas will further complicate the development of a comparable revenue measure. Again, the new approach sacrifices the accuracy of the actual cost comparison paradigm.

2. The Joint Board Benchmark Underestimates the Rural Rates for Universal Service Under its Proposed Benchmark.

The Recommendation's earlier discussion of "affordable" rates (¶¶ 112-33) correctly concludes (¶ 128) that the scope of service obtained for local rates in a rural area, the "community of interest" for rural subscribers and the relationship of local and toll rates for rural customers are relevant to the question of "just, reasonable and affordable rates." The

Joint Board's effort to take these relevant factors into account indirectly in its proposed benchmark based on average revenues from local, access and "discretionary" services" only partially addresses these differences. For example, the Recommendation correctly notes (¶¶126-30). that comparisons of rates are not a reliable measure of average costs borne by customers because of the above-identified rural differences and other issues relevant to local rates, such as variations in rate design and the Joint Board's decision to support only first lines for primary residences and single line businesses.[21]

Proceeding from its correct conclusion that local plus toll rates must be balanced in evaluating "affordability" for rural rates, the Joint Board makes an unwarranted inference from information that rural LECs often recover a larger share of their costs from toll access (n.1011). The Joint Board infers that it can use those ILEC revenues to make assumptions about how much will be left for customers to pay once those revenues have been generated and to set support to cover the remaining costs. The apparent reasoning is that so long as customers need not generate more revenue than the nationwide average benchmark amount to make their routine and emergency calls within their community of interest, their rates must meet the statute's universal service standards. As a result, the Joint Board presumes (¶317) that the national average revenue indicates that such

> [o]ther service revenue can offset the high cost so that residential and single business rates remain affordable even in above average cost areas.

The Joint Board did not realize that the access revenues in question, and the rate ceiling

[21]Current revenues for local rates reflect the current broader high cost compensation plan.

that it had inferred, do not include the toll charges rural customers incur for calls to their community of interest. Equating access revenues, paid to RLECs by interexchange carriers, with the level of services that rural subscribers have already purchased simply forgets the rural subscriber's toll bill from the interexchange carrier for calls that are covered by the local rates in urban areas. The Joint Board has, thus, overlooked its earlier recognition (¶ 129) that some customers cannot call their "pertinent 'community of interest' " to reach "hospitals, schools, and other essential services without incurring a toll charge." The Joint Board's apparent presumption, that when an RLEC receives access revenues it means the same thing in rural and urban areas results, essentially, in the irrational claim that a higher cost recovery from rural customers is "just, reasonable, and affordable" and "reasonably comparable" to the rates in urban areas. In other words, the presumption itself — that the national average revenues benchmark puts rural and urban subscribers on the same footing — is inconsistent with the universal service principles: The mechanism itself builds in a heavier cost recovery responsibility for rural customers before high cost compensation will offset the high costs of serving rural areas because nationwide local, access and vertical service revenues do not provide the same package of services in rural areas. The current accuracy of measuring actual costs and supporting those that are enough above average actual costs has been lost in the Joint Board plan.

There is a practical problem presented by the inclusion of access revenues that makes it impossible for RLECs that participate in the National Exchange Carrier Association (NECA) tariffs and pools to discern their access revenues per line under the proposed classifications.

Only non-pool members can classify revenues that way. The pooling process identifies gross access revenues, but not broken down by first primary residence and single-line business connections. Even if such information were available for pool members, their relative size would lead to data that reflect urban, not rural, historical revenues.

3. The Benchmark Wrongly Assumes that Revenues Per Customer and Available Discretionary Services are Uniform in Rural and Urban Markets.

In addition, the nationwide revenue standard is likely to overstate the revenues per line in rural areas because it assumes that revenues per customer and revenue-generating services for LECs are the same in rural and urban areas. Rural area characteristics will be submerged by urban market facts in a nationwide average because of the relatively tiny number of rural customers. But rural areas are not likely to offer the same choices and prices for vertical or "discretionary" services (and RLEC revenues) as more advanced urban areas. On top of that difference, the levels and share of costs recovered through rural and urban access charges is virtually certain to change in the access charge proceeding to be commenced before the end of this month.

4. The Benchmark Will Be Difficult to Administer.

The Recommendation also fails to fulfill its stated goal of establishing an administratively simple benchmark. Developing two benchmarks to differentiate classes of residential and business connections will require new records and impose difficult data collection burdens. LECs do not collect and update information about whether a line serves a customer's primary residence. They do not keep records of revenues separately for residential or business calling or revenues based on the number of household or business connections a customer has. They do not collect data on what connections their customers have with other providers, such as cellular or cable television systems. Nor would there be any way to tell which connection to a multiple line residence — or which carrier -- should receive high cost compensation as the first line. Yet, there is certainly no authority in the statute to deny high cost recovery to all of a rural residential customer's lines because he has more than one. Thus creating two separate benchmarks for the two narrow classes to be eligible for high cost compensation under the new universal service scheme will be difficult. The information will be outdated in any event as soon as the charges for connections no longer eligible for support face substantially different charges. It can only be rational to rely on historical revenues as a benchmark of what customers are spending or LECs receiving if the prospective rules are going to be set to recover actual costs.

The Commission needs to find a practical way to adjust for rural differences in whatever benchmark it uses. The use of actual costs or an adjusted rates measure as a benchmark should be seriously considered. If the benchmark is not tied to rates, it is hard to see how the Commission can apply the statutory principles to see if the rates will be lawful or that the support will achieve the 1996 Act's universal service purposes. Whatever the merits of comparing revenues with costs, the proposed benchmark misses the mark. The proposed formula cannot support a conclusion that the high cost compensation it calculates will be "specific," "predictable" and "sufficient," that rural customers' rates will be "just, reasonable and affordable" and that rural and urban customers will enjoy "reasonably comparable" rates and services. The statute demands no less.

IV. BIFURCATED TREATMENT FOR RLECS AND OTHER LECS IS SOUND, BUT SHOULD BE FULLY CONFORMED TO THE SECTION 254 PRINCIPLES AND PURPOSES.

A. Support for RLECs During the Transition Must Be Defined and Distributed on a Consistent Basis.

The Recommendation prudently establishes (¶ 272) a transition period for RLECs, in large part to "minimize any disruption or adverse impact" of its proposal "on the rural carriers." It explicitly points to "receiv[ing] levels of support different from what they currently receive" (¶¶ 184, 272) as a concern for RLECs that it has addressed by the transition proposal. The transitional high cost compensation it recommends would, accordingly, "be based on historical per line amounts" (ibid.), that is, on "embedded costs" (¶356).

The fallacy of using cost, revenue or support per line as the unit of measurement for two or more lines again infects the determination of appropriate high cost compensation in rural markets. A serious problem will result from measuring support per line and making the support "portable." If a CLEC obtains the ILEC's support per line when the CLEC takes any customer, it will distort the ILEC's recovery of its extensive common costs. Even though the CLEC acquires the ILEC's line at the ILEC's incremental cost under the interconnection requirements, the costs of the ILEC will still not decline in proportion to the number of lines lost to competition. The problem will not be alleviated or put off by freezing a LEC's historical support per line during the transition period.

The Joint Board has not even committed itself to using the same historical line eligibility standards in calculating the transitional support per line that the RLEC and the CLEC will receive. While the only fully responsive change would be to move to a cost per customer measurement for all steps in any proxy and benchmark model, the recommended interim measure may not even correctly translate historical support per line amounts into transitional amounts. The Commission should at least clarify that the same definition of eligible "lines" will be used to calculate the "historical per line amounts" for RLECs and the high cost compensation per line RLECs will receive during the transition period. The Joint Board, as noted earlier, recommends limiting high cost compensation under the new system to two narrow classes of lines. It would also (¶296) declare even transitional support "portable."[22] If the Commission adopts these proposals, it should consider (a) dividing each RLEC's current high cost compensation by the primary residence and single-line business connections lines that will be eligible for high cost compensation in the future and (b) distributing this transitional per-line amount to the same two classes of lines during the transition. Alternatively, it would also be logical and consistent (a) to calculate current support per line using the lines currently eligible and (b) to distribute that "historical per line amount" on the basis of the same historical universe of all access lines. What would not be rational, and the Commission must consequently avoid, would be calculating per line support using the currently eligible lines, but distributing that amount only to initial primary residence and single line business connections. That use of disparate definitions of a term used twice in the transitional formula would sharply

[22]Presumably the Joint Board intends "portability" only to a duly designated "eligible telecommunications carrier" (ETC), as the law commands in sections 214(e) and 254(e).

reduce high cost compensation. An immediate, unbuffered revenue loss — added to the new universal service outflow for RLECs owing to the obligation to contribute — would defeat the basic purpose of the transition (¶ 272) -- "to minimize any disruption or adverse impact of this change [in the definition of eligible lines] on the rural carriers" during the transition.

B. The Freeze on High Cost Compensation During the RLEC Transition Goes Further than the Act Permits.

The Joint Board recommends (¶ 289) freezing high cost compensation for RLECS during the transition at the per line amounts received from the Universal Service Fund (USF) in 1997 (i.e., based on 1995 USF data filed with the Commission by NECA) and DEM Weighting and LTS high cost compensation received in 1996. The Joint Board's reason for freezing support is the incentive to overinvest predicted by economic theory. The Recommendation relates this theory -- for which it has no factual support -- mainly on the subgroup of LECs with costs exceeding 150% of the national average costs, who currently recover their full investments over this level via high cost compensation.[23]

Recognizing that too rigid a freeze in high cost compensation will impair network upgrades to serve new customers, the Recommendation (¶ 290) would allow new lines to qualify for the "historical per line amount." However, the Joint Board has suggested no other means of recognizing either large "lumpy" rural investments or more gradual additions of costs in high cost areas except to the extent the changes happen to increase lines enough to make up

[23]The Record does not disclose any evidence of inefficient investment or expenses incurred by these RLECs or any other ILECs. The Recommendation apparently discounts state regulation and RUS requirements that ILEC investments be prudent.

the difference. In fact, it seems not to take seriously the Act's clear mandate for network and service advances.[24] The freeze thus violates the statutory directive in section 254(e) for "sufficient" high cost support to achieve the purposes of the Act. The sufficiency principle is not limited to advances that lead to new lines. Indeed, the freeze is already out of date: Many LECs have already made their new investments for 1996 and even their commitments for 1997. Their high cost compensation will not be "sufficient" even to support costs already incurred this year in reliance on the Act's promise of "sufficient" continuing high cost mechanisms.

Given that Congress enacted universal service principles and standards that emphasize evolution of universal service and advancing service in all parts of the nation, as well as section 704, which encourages setting incentives for rural investment in infrastructure improvements, it is not lawful or sound national policy to "freeze" high cost compensation, even for a 3- or 6-year transition period. The Commission should provide for "exogenous" cost treatment that allows increased high cost compensation for network improvement costs, or at least a major part of them. It should also provide an adjustment factor increasing frozen high cost compensation at a rate consistent with healthy investment in this important national asset, the public switched network.

C. RLECs Must Be Permitted to Disaggregate High Cost Support During the Transition.

The Recommendation (¶167) discusses at some length the strong record support for allowing LECs to disaggregate the support for their study areas to prevent support windfalls to CLECs. It describes the points made in joint Century and TDS filings (ibid.) and adopts a

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[24] See §254 (b) (3) and §704.

general disaggregation policy (¶ 178). However, the Joint Board unaccountably denies that policy for RLECS, although it properly follows the intent of Congress in retaining study areas (¶¶ 172--74) as the geographical universal service area for state ETC designations under section 214(e). The Recommendation concludes (¶ 178) that, regardless of the size of the service area set by a state for any large carrier, the Joint Board may step in and disaggregate to smaller geographic areas for support purposes:

> We believe that it would be consistent with the 1996 Act to base the actual level of support, if any, that any non-rural telephone company carriers would receive for the service area on the costs to provide service in sub-units of the area.

(emphasis added). Its authority and the policy basis are the same for RLEC, but the Joint Board does not reach the same result.

The need for disaggregation is equally acute in RLEC areas, without regard to when or even whether a proxy model applies. Disaggregation would target rural high cost support, both during the transition and thereafter. Such targeting would limit the support burden on the nation's ratepayers and avoid perverse incentives to creamskim in RLEC study areas. Absent disaggregation, a CLEC may (a) obtain designation as an eligible carrier to serve an RLEC's rural study area, (b) build facilities only to the lowest-cost population center, (c) serve outlying rural territory by reselling the RLEC's subsidized (i.e. acquired by the reseller below cost) high cost services at rates below the subsidized retail rates, and (d) collect windfall support both for the low cost hub and its resold service based on the RLECs average support for serving the entire area with its own network.[25] A CLEC would have an incentive to enter the rural market not only if it could undercut the RLEC's costs in the denser hub, but also to pocket the difference between its cost to serve Main Street and its support based on higher averaged costs and its windfall from resold service. Such entry is inefficient, distorts the marketplace and leads to facilities duplication where it may not otherwise be economic.

Without disaggregation, the RLEC would also lose the average support for serving in town for each customer that switched to a competitor. But only the below-average costs in town have made the averaged support level sufficient for serving the higher cost outlying customers at below-cost rates. Thus, the average historical cost-based support per line would result in a shortfall in the revenues for serving the outlying territory. The RLEC's only recourse would be to raise its local rates in the more rural areas, if the state permits, reduce the quality of its service or operate at a loss. Electing to adopt a proxy early, before the proposal has been "tailored" and "improved" to the point that it is suitable for individual RLECs, would not be a realistic or publicly beneficial alternative.

The best policy would be for the Commission to permit RLECs to disaggregate their support during and after the transition. It would not be necessary to require major new cost studies for the period while a satisfactory proxy for RLECs is developed and tested. For example, it would be sufficient to allow the RLEC to divide its study area into three or more

[25]The Recommendation states (¶290) that even a reseller or user of unbundled elements will get portable support based on the ILEC's costs. However, the statute forces the ILEC to price resale and unbundled elements provided to other carriers below retail rates and actual cost. 47 U.S.C. §251(c)(3) and (c)(4).

zones, much as the Commission told the states to do for their states in the interconnection decision. This allocation would target the most support to the highest cost parts of each market and withhold extra support from the RLEC and any other LECs for serving its downtown "cream" locations.

Allowing RLECs to disaggregate would provide market signals much more in harmony with what a proxy model is intended to do. It would avoid windfall support that would violate the Act's requirements that all support be used on ly for the service for which it is provided (§254(e)) and the prohibition against cross-subsidy (§ 254(k)), since all ratepayers would be paying excess support if windfalls occur. It would also avoid the incentives for an overcompensated CLEC to use its windfall to charge predatory rates in that or other markets it serves.[26]

V. COMPETITIVE BIDDING CANNOT BE RECONCILED WITH THE ACT.

The Joint Board (¶ 341) exercises sound judgment in recommending "that the Commission refrain from adopting a competitive bidding plan at this time." However, the Joint Board urges continued consideration of ways to design a satisfactory auction model for setting federal high cost compensation.

TDS and Century remain convinced that competitive bidding to set support levels in RLEC service areas cannot be designed in a way that would be lawful under section 214(e). The Joint Board acknowledges, as it must, that only ETCs would be able to participate. The

[26] See, John C. Panzar and Steven S. Wildman, Competition in the Local Exchange: Appropriate Policies to Maintain Universal Service in Rural Areas, pp. 17-25.

law would thus leave it solely up to the state to control who could participate in an auction involving an RLEC study area. The state must make a public interest determination before it allows an additional carrier to receive support in a rural area. The state also has sole authority over a provider's request to be relieved of eligible carrier status and duties and an ILEC's heavier carrier of last resort obligations.. Forcing the state to use an auction to set high cost compensation and providing losing bidders with less than sufficient support would violate section 254(e), interfere with the state's authority over withdrawal and could undermine the basis for the state's public interest finding with respect to designation of an additional ETC. The result of an auction, for example, could be to compensate the only fully facilities based ETC below what it needs to operate those facilities, even if the low bidder could bid below the ILEC's cost because it was using the ILEC's network or reselling the ILEC's services for a discounted price.

Determining what competing LECs will receive as high cost compensation based on the lowest bid would also deny "sufficient" support to the other bidders. It would also mean that support would not be "predictable" or "specific" to each ETC, as the Act dictates. Expecting a losing bidder to continue to serve as the carrier of last resort even if its business cannot remain profitable with the inadequate support based on the winning bid and it cannot raise its rates would raise constitutional issues. In contrast, a rule allowing withdrawal as an ETC for losing bidders would invade the authority left in state hands by section 214(e)(2).

Since the Joint Board has not recommended competitive bidding, the Commission should not waste the limited time left for its universal service decisions implementing section 254 on this issue. If any proposal is to be considered in the future, an opportunity for public participation would be essential. For now, the Commission should devote its attention and resources to the immediate task of designing a universal service system that fully meets the requirements of law and implements the will of Congress.

VI. CONCLUSION

The Commission must decide complex and important issues concerning universal service in the near future. TDS and Century will remain involved as the Commission, with state participation, works toward a proxy that will be suitable for RLECs as well as other LECs. We urge the Commission to keep in mind the serious legal and constitutional questions raised by using forward-looking proxy costs, particularly given the unique characteristics and variability of actual cost results for RLECs. TDS and Century also urge the Commission to tailor its further consideration and action on the Joint Board's Recommendation to meet the following rural universal service concerns:

1. Adopt a two step collection process that (a) apportions carrier responsibility for federal universal service contributions on a consistent economic theory, rather than levying on gross revenues net of payments to other carriers and preventing RLEC recovery of a fair share of contribution from its carrier-customers, as economic theory requires, and (b) provide for a uniform, nationwide surcharge on retail customers' bills to fulfill the Act's "explicit" support mandate;

2. Ensure that any cost identification methodology fully accounts for rural conditions, allows for adequate, sufficiently individualized rural LEC inputs and streamlined waivers and that parties have an opportunity to comment on and price out a specific proposal before a plan is imposed on RLECs and rural customers;

3. Develop a high cost support benchmark that — whether based on cost or rate comparisons or an improved revenue average that reflects future revenues and rural differences — reliably